UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Case Nos. 08-13555 (SCC); 08-01420(SCC)(SIPA)

- -x

In the Matters of:

LEHMAN BROTHERS HOLDINGS INC., et al.

Debtor.

- -x

LEHMAN BROTHERS INC.,

Debtor.

- -x

United States Bankruptcy Court

One Bowling Green

New York, New York

July 30, 2014

10:03 AM

B E F O R E:

HON. SHELLEY C. CHAPMAN

U.S. BANKRUPTCY JUDGE

Motion Pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure and Section 105(a) of the Bankruptcy Code for Approval of Partial Settlement Agreement Relating to SGS HY Credit Fund I (Exum Ridge Cbo 2006-3) Swap Agreement and Indenture [ECF No. 44723]

Motion Pursuant to Federal Rule of Bankruptcy Procedure 9019 for Entry of an Order Approving Settlement Agreements Between the LBI Trustee and the Singapore Entities [LBI ECF No. 9358]

Motion Pursuant to Federal Rule of Bankruptcy Procedure 9019 for Entry of an Order Approving Settlement Agreement Between the LBI Trustee and the Hong Kong Entities [LBI ECF No. 9363]

Trustee's Motion for an Order Pursuant to Sections 105(a), 502(a), 502(c) and 726 of the Bankruptcy Code and Bankruptcy Rule 3009 (I) Capping the Maximum Allowable Amounts, and Establishing an Interim Distribution Fund, for Unsecured Claims, (II) Allowing Certain Unsecured Claims, (III) Authorizing the Trustee to Make a First Interim Distribution to Allowed Unsecured Creditors with a Record Date of July 15, 2014, and Related Relief [LBI ECF No. 9246]

Transcribed by: Lisa Beck

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P R O C E E D I N G S

THE COURT: All right? I believe we're going to start with LBHI.

MS. MARCUS: Good morning, Your Honor.

THE COURT: Good morning, Ms. Marcus.

MS. MARCUS: Jacqueline Marcus, Weil, Gotshal & Manges LLP, on behalf of Lehman Brothers Holdings Inc. as plan administrator and its affiliated Chapter 11 estates.

We're here this morning, Your Honor, for the hearing on the motion pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure and Section 105 of the Bankruptcy Code for approval of partial settlement agreement regarding to SGS HY Credit Fund (Exum Ridge Cbo 2006-3) swap agreement and indenture. And that's ECF number 44723.

With respect to the procedural context, we filed a motion on June 16, 2014 and did not receive any objections prior to the July 9th objection deadline. As a result, rather than proceeding with a hearing on this matter at the July 16th omnibus hearing, we filed a certificate of no objection. At the Court's request, we appear today for a hearing on this matter.

THE COURT: My questions go not to the merits of the settlement at all. And those will be approved. My question is purely procedural. And that is, it's denominated a partial settlement agreement. As far as I can tell, it does not

contemplate dismissal of the adversary proceeding as to this issuer. So it's my understanding, based on reading the papers -- specifically, I'm looking at paragraph 14 of the motion -- the litigation involves this dispute that's being settled and other similar disputes involving other issuers and trustees. So my questions are really procedural. One, why the adversary is not being dismissed as to this issuer. And secondly, my understanding is that this was filed in the main case but not in the adversary.

MS. MARCUS: Sure.

THE COURT: So I hate to be --

MS. MARCUS: That's fine. That makes my life much easier.

THE COURT: -- ask about these technicalities but just needed to know the answers to those questions.

MS. MARCUS: Sure. So the reason that it's described as a partial settlement agreement is because under the structure of the settlement, noteholders were provided with notice and an opportunity effectively to opt out of the settlement. If any noteholder who received the notice provided by the trustee didn't want the settlement then it would opt out and funds would be placed into an escrow account for the benefit, basically, of that noteholder. If that noteholder chose to litigate or there were some other settlements down the road, those funds would be there. And that's why it was not

deemed a full settlement.

THE COURT: Okay.

MS. MARCUS: As it turns out, however, when we filed the motion, of course, we didn't know if there would be any objections.

THE COURT: Right.

MS. MARCUS: So it was denominated as a partial settlement. As it turned out, no noteholders --

THE COURT: Okay.

MS. MARCUS: -- have opted out and therefore it actually is --

THE COURT: Okay.

MS. MARCUS: -- a settlement. And the adversary proceeding actually will be dismissed --

THE COURT: Okay.

MS. MARCUS: -- as to this issuer.

THE COURT: Okay.

MS. MARCUS: I think the way -- the settlement agreement, I think, says that the -- when the escrowed funds are distributed.

THE COURT: Okay.

MS. MARCUS: And the escrowed funds would be only for objecting noteholders.

THE COURT: Right.

MS. MARCUS: So now, standing before you today, is a

complete settlement --

THE COURT: Okay.

MS. MARCUS: -- as to this issuer.

THE COURT: Okay. And therefore, the adversary will be dismissed as to this issuer and that is an order that can be filed in the adversary.

MS. MARCUS: That is exactly right. And just as to your other question as to why we filed in the main case instead of the adversary, one reason is that's how we've always done it although that's not the most satisfying reason. And if our associate -- if an associate told me that, I might take issue with that explanation. But the other is that it provides broader notice because in the main docket --

THE COURT: Sure.

MS. MARCUS: -- it's on the Epiq website. Everybody sees it. And part of the effort of -- well, us and the trustee, has been to provide as broad a notice as possible.

THE COURT: Sure. So I don't have an issue with that. My issue is just with dotting the i's and crossing the t's in the adversary because then if you just look at the adversary docket, you don't see the disposition. Right? So you can file it in both places and then all purposes are served.

MS. MARCUS: And then the stipulation of dismissal itself will be filed in the adversary docket.

THE COURT: In the adversary. Absolutely perfect.

MS. MARCUS: If those are all your questions then --

THE COURT: Those are all my questions.

MS. MARCUS: -- then I'm done.

THE COURT: So I will enter the appropriate orders.

MS. MARCUS: Would you like us to revise the order to strike "Partial"?

THE COURT: That would be lovely.

MS. MARCUS: Okay.

THE COURT: All right?

MS. MARCUS: So we'll do that and submit a revised order.

THE COURT: Okay.

MS. MARCUS: Great.

THE COURT: Thank you very much.

THE COURT: Thank you.

Okay. Next we'll turn to the LBI agenda, please.

MR. KOBAK: Good morning, Your Honor. James Kobak, Hughes Hubbard & Reed, for the SIPA trustee.

THE COURT: Good morning.

MS. MARCUS: Your Honor, on your calendar this morning are three motions. The first two will be presented by my partner, Michael Salzman, and they involve settlements with various affiliates and entities in Singapore and Hong Kong that are accretive to the estate. The last thing on our calendar is a very significant motion to allow us to set reserves for

unsecured claims and allow the trustee to commence interim distributions of at least three billion dollars. This really marks a very, very major milestone in our liquidation. It is the result of a tremendous amount of work in analyzing, resolving, negotiating, litigating, mediating, I think, between 12 and 13,000 claims totaling tens and tens of billions of dollars. That work continues even as I speak. As a result of that work and communications with claimants since the motion was filed, there is not a single real opposition to this motion and all the major creditor constituencies, as well as SIPC, support it.

My associate, Megan Grad, has done an absolutely wonderful job of leading our team on this effort. So it seemed to me it would be fitting for her to present this motion today. And she'll be assisted by Mr. Farrell and Ms. Hoffer who are members of her team.

THE COURT: Very good.

MR. KOBAK: Thank you.

THE COURT: Thank you. I think it would be best for you to remain sitting.

MR. SALZMAN: Thank you, Your Honor. I appreciate that. Michael Salzman from Hughes Hubbard & Reed, attorney for the SIPA trustee in Lehman Brothers Inc.

As Mr. Kobak said, we're here seeking approval of two settlements with foreign Lehman affiliates. I myself was last

before Your Honor in connection with a settlement we reached with Lehman Brothers Japan. And now we've reached a settlement with fiduciaries who represent interests of Lehman Brothers affiliates in Singapore and Lehman Brother affiliates in Hong Kong, two separate sets of fiduciaries, one geographically based in Hong Kong, one in Singapore.

I'm happy to say that no opposition has been filed to either one. First -- the first motion up is the Singapore one. That involved six agreements. They were attached to our motion. As I said, there's six agreements but they're with the same fiduciaries, just different entities -- legal entities in Singapore.

This agreement was the product of international cooperation between us and the Singapore fiduciaries and their attorneys and accountants on both sides. And it was a long process of reconciliation of books and records by the accountants and also thereafter arms-length negotiation of our points that needed to be compromised.

Your Honor has the agreements themselves. Let me just summarize the key terms. The trustee is receiving approximately 300 million dollars in exchange -- deriving from two accounts in Singapore that concerned exchange traded derivatives. The Singapore entities are receiving approximately three million dollars as a general unsecured claim or claims here. And the trustee's recovery concerning

the exchange traded derivatives is subject to the dispute with Barclays that's being litigated now in the Second Circuit. But then -- so Barclays has become a party to this agreement and it's agreeing that this money can be repatriated to the United States on this basis, subject to their rights. The trustee has reserved for these Barclays contingency and so receiving this money into the Lehman Brothers estate will be accretive to the estate.

As set forth in our papers, we think this agreement -- set of agreements clearly is in the best of the estate. The Iridium factors are very easily met in this case. And so, we ask Your Honor to enter the proposed order with respect to the Singapore settlement.

THE COURT: All right. Thank you very much. Does anyone else wish to be heard with respect to LBI's motion for approval of the settlement between the LBI trustee and the Singapore entities?

All right. I quite agree that the settlement easily satisfied the Iridium factors and is in the best interest of the estate and I'm happy to approve it.

MR. SALZMAN: Thank you, Your Honor. With that, I'd like to move next to the Hong Kong agreement. It's a single agreement but it does involve multiple entities on the Hong Kong side who will have in common the same set of fiduciaries.

This agreement is subject to approval in Hong Kong as

well as here. As in the case of Singapore, I can say that we had excellent cooperation between our side and the fiduciaries in Hong Kong and their attorneys. Barclays was also a party there and other Lehman affiliates around the world also were involved in proceedings in Hong Kong. So we do appreciate that.

There was a process of reconciliation and negotiation that led to this agreement. And to summarize the key terms, the trustee will be receiving approximately 71 million dollars as a trust claim in the Hong Kong proceedings. The trustee is receiving an unsecured claim for approximately 16 million dollars. The Hong Kong affiliates are receiving a general unsecured claim for approximately 233 million dollars from us. And the trustee's trust recovery in Hong Kong is likewise subject to the Barclays litigation contingency but again has been reserved for and is also accretive to our estate.

As our papers say, we think we again easily meet the Iridium factors and this is in the best interest of the estate to reach the settlement today and be able to proceed with that settlement. And so, we ask the Court to enter the proposed order with respect to the Hong Kong settlement.

THE COURT: All right. Thank you. Does anyone wish to be heard with respect to the motion to approve the settlement agreement between the LBI trustee and the Hong Kong entities?

Okay. I quite agree the settlement easily satisfies the Iridium factors and clearly is in the best interest of the estate. And I'm happy to approve it.

MR. SALZMAN: Thank you, Your Honor.

THE COURT: Thank you very much.

MR. SALZMAN: Thank you.

THE COURT: All right. So that brings us to the next matter which is the motion to establish interim distribution fund and related relief.

Good morning.

MS. GRAD: Good morning, Your Honor. Megan Grad of Hughes Hubbard & Heed for the SIPA trustee. I've been involved in this case in different capacities since its commencement the most recent of which has been overseeing the general day-to-day administration of the general claim process. So I'm both personally and professionally gratified to be here before the Court on this very significant motion that will allow us to begin making distributions to unsecured creditors.

Specifically, we are asking the Court today for an order capping the maximum allowable unsecured amounts for (indiscernible) unresolved general creditor claims. Allowing certain unsecured general creditor claims, authorizing the trustee to establish an interim distribution fund of three billion or more for purposes of making an interim distribution to allowed unsecured general creditors and reserving for

remaining unresolved claims and, finally, authorizing the trustee to make a first interim distribution from the LBI general estate to allowed unsecured creditors with a record date of July 15th.

As presented to the Court at the hearing in June on the secured and priority claims reserve motion, the relief we are seeking today is a necessary component of the trustee's overall plan to begin distributions to unsecured general creditors.

The first part of the plan was to cap claim amounts and set reserves for secured and priority claims and to authorize the trustee to make a distribution to allowed secured and priority creditors. That part of the plan was set in motion last month with the Court's order. As a result, more than 240 million is in the process of being to fully satisfy the allowed claims of secured and priority creditors, the majority of which are former employees of LBI.

Now we're here at the second part of the plan. To get us to the point where we are today, with the Court's help over the years and the advice and oversight of SIPC, the trustee has made significant and historic achievements in the SIPA liquidation and in administering the largest and most complex general estate claims process of any broker-dealer failure.

When this liquidation began, it was far from certain that a distribution to general unsecured claims would ever be

possible. That we're seeking authority and approval from the Court today to take the necessary steps towards a distribution to unsecured creditors is extraordinary. The prospect of any meaningful LBI general estate was a welcome development that came about only after major settlements with LBI's affiliates, in particular LBHI and LBIE, Lehman Brothers International Europe, were achieved enabling the trustee to ensure hundred percent distributions to allowed SIPA customer claims. With those settlements in principle reached towards the end of 2012 in keeping with the Securities Investor Protection Act, the trustee began an assessment of general creditor claims. And as it became clear that customers would receive a hundred percent on their claims with the settlements final, the trustee devoted substantial resources to the general estate claims through the deployment of a strategic plan of pursuing consensual resolution of claims through settlements and voluntary withdrawals, pursuing objections and ascertaining the validity amount of allowed claims.

As the Court heard last month, there have been more than 13,000 general creditor claims including reclassified customer claims and administratively split claims asserted against the estate in the amount of 127 billion. Overall, the trustee has resolved more than 12,000 claims by settlement, withdrawal, order or otherwise. To date, the trustee has filed more than 250 omnibus objections to claims as well as many

other individual objections. There are currently almost 900 claims pending before the court and an initial approximately 700 outstanding claims remaining to be resolved. Some of these claims are currently being litigated and mediated and still others will be litigated.

We're continuing to work on resolving remaining claims every day and since we were before the Court last month on the secured and priority reserves motion, we've continued to make significant progress. However, resolving disputed claims inevitably will take time.

At the same time, as the Court heard last month, a significant amount of cash is available for the general estate. The LBI general estate currently has three billion dollars available to make both an interim distribution and reserve an appropriate to protect the interests and due process rights of the holders of unresolved claims. We believe that it is time to begin distributing that money to creditors.

However, to accomplish distributions to allowed creditors, the trustee also must protect creditors with disputed and unresolved claims. Thus, the motion that we're presenting today has two aims. First, to get money out to allowed unsecured creditors as soon as possible while also protecting claimants who have disputed or unresolved claims. Like the secured and priority reserves motion, this motion is designed to provide the trustee and the creditors of the LBI

estate with the certainty necessary to begin making distributions. It does this by establishing final capped maximum amounts for remaining unresolved or disputed unsecured claims and establishing and interim distribution fund for purposes of reserving for remaining unresolved claims and making a distribution to allowed creditors.

Second, the motion is designed to protect all creditors' due process rights. All outstanding general creditor claimants were served with the motion and schedules and have the opportunity to be heard by this Court about the relief sought in the motion. The trustee also permitted in the motion to working cooperatively with claimants to address any concerns and set up a call center for this very purpose. With respect to our communications with claimants, we had more than a hundred from claimants into the call center. In addition, there were many other discussions with claimants outside the call center including discussions right up to submission of our revised schedules with the Court.

In most cases, our communications with claimants involved answering questions. In other cases, we made changes to the schedules to the motion on the proposed order to address their concerns. Overall, there were only five responses to the motion and four of them have been withdrawn. Greg Farrell will provide further detail on the responses in just a moment. And Dena Hoffer is here and prepared to provide an overview of

changes we made to the revised schedules that we filed on July 28th.

There's not one single remaining objection to this motion. There is a reservation of rights which we believe is not -- unnecessary in this context. But there's no actual objection from any of the thousands of creditors served with and who will benefit from this motion.

The ad hoc group of creditors in the holding company by far are the largest creditors representing some fifty percent of our remaining claims, have filed papers in support.

Entering this order will benefit creditors. It's supported by SIPC; it's supported by major creditors of the estate. If Your Honor has any questions, I'm here to answer them. Otherwise, we respectfully request that the Court enter the order.

THE COURT: Well, let's take a moment to pause because I think a number of the things that you said are worth emphasizing. I'm relatively new here. But I think it's important to note that this is indeed a very historic and important moment in the case. As you said, when you look back five years, the notion that all customer claims will be paid, the notion that all secured and priority claims would be paid, the notion that there would ever be anything for unsecured creditors was not something that I think many folks contemplated.

Now we're in a world in which discussions are taking place at very high levels in Congress, the Federal Reserve, other parts of the government about how to avoid another Lehman. And yet, when you look at the process that occurred here under Judge Peck's watchful eye, and in the hands of people like you, from my perspective at least, the result is indeed extraordinary. And I think it's important to note and I think it's important for the general public to understand that what this means is that ordinary creditors in fact are going to be getting a distribution. And that is indeed a Herculean achievement for which I congratulate you and your team and your colleagues and everyone indeed around the world who has helped contribute to the result.

So I think it bears special emphasis that this is indeed an extraordinary accomplishment and evidence of how well, in fact, the system works. Yes, it took five years. But given the magnitude of the claims and the magnitude of the many complexities involved, I will say it only took five years. And the fact that you're standing here with their being no objections to the relief requested is evidence of how clearly it's been presented to the general creditor population so that they understand that, in fact, their rights have been protected.

So thank you.

MS. GRAD: Thank you.

THE COURT: Did you want to address specifically the reservation of rights? I think you alluded to it and I share your observation that it's really not your main to the relief that's being requested today. And accordingly, I find that there's no additional language that needs to be added to the order to address that reservation of rights.

MS. GRAD: I'd like my colleague, Greg Farrell, to talk about it. If you have any further questions about it --

THE COURT: Well, I'm happy to--

MS. GRAD: -- he's prepared --

THE COURT: I'm happy to hear from him if he prepared something to say.

MS. GRAD: Thank you.

MR. FARRELL: Good morning, Your Honor. Gregory Farrell from Hughes Hubbard & Reed for the SIPA trustee. Given what you just said, I'll just say that there were five responses filed to the motion. Four of them have now been withdrawn.

THE COURT: Right.

MR. FARRELL: The remaining one is the reservation of rights. That's not a real opposition to the motion --

THE COURT: Right.

MR. FARRELL: -- or the relief requested therein.

THE COURT: That's at docket 9440. It's the reservation of rights of Mssrs. Chambers, Verghese and Kettler,

correct?

MR. FARRELL: Correct, Your Honor.

THE COURT: Okay.

MR. FARRELL: We agree with what Your Honor just said that the proposed addition that they requested to the proposed order is not necessary or germane to the motion. I guess I'll leave it at that. I understand their counsel is here.

THE COURT: Right. And their rights are in no way adversely affected by the order and therefore that's yet another reason why there's no language necessary to -- in response to their reservation of rights.

MR. FARRELL: We agree, Your Honor.

THE COURT: All right. Thank you very much.

MR. FARRELL: Thank you, Your Honor.

THE COURT: All right. Would anyone else like to be heard with respect to the motion?

All right. I'm happy to grant it.

MR. KOBAK: Thank you, Your Honor.

THE COURT: All right? There's nothing else, is there?

MR. KOBAK: No. That concludes our calendar, Your Honor.

THE COURT: Okay. We're going to take a short break. And then I'll come back and then I have one more matter on the 10 o'clock calendar and that's ConnectEdu. So if you would

give me ten minutes, we'll turn to that next matter. Thank you.

(Recess until 2:03 p.m.)

THE COURT: All right. We are here today on the motion of the 341 individual claimants to compel arbitration.

Good afternoon. How are you?

UNIDENTIFIED SPEAKER: Good afternoon, Your Honor.

THE COURT: Would you like to start?

MR. LYMAN: Good --

THE COURT: Do I have someone on the phone?

MR. LYMAN: Yes, you do, Your Honor. This is Charlie Lyman on behalf of Mr. James Knipp, who is joining in the motion, but he's not part of the group at this point.

THE COURT: All right. Thank you, sir.

MR. SCAROLA: Good afternoon, Your Honor.

THE COURT: Good afternoon.

MR. SCAROLA: Rick Scarola. I'm one of the attorneys at Scarola Malone & Zubatov. My colleague, Alex Zubatov, is at counsel table with me.

THE COURT: All right.

MR. SCAROLA: The motion is (indiscernible - :55), and I try not to go over -- I assume Your Honor --

THE COURT: Please. I've read everything multiple times.

MR. SCAROLA: Okay. I mean, in our view, it's as

compelling a case for arbitration in the bankruptcy context as there might be for the following reasons. Core or not core, there is still a presumption in favor of arbitration, and it's the trustee's burden for the party opposing arbitration's burden to overcome that presumption, and I don't think they will overcome that presumption here, but cases discuss what the salient factors are in a number of different ways.

I've thought about -- since you've -- I expect you've read the papers -- to talk about the salient factors in terms of four. The first one is the obvious and the one pounded on is the state law issues being the predominant issues and the fact that even Section 501(a) refers to a contractual subordination being something that's to be given effect (sic) in accordance with applicable law here, the law in the state of New York.

THE COURT: But see, that's where there begin to be internal inconsistencies. Because you say that, but then, one of the big points that you make is that this should be arbitrated by FINRA in accordance with the Constitution and rules of the New York Stock Exchange. So that's different.

MR. SCAROLA: Is the issue that what's culled (sic) out in the agreement and was the New York Stock Exchange -- I mean, in our view, the jurisdiction of the New York Stock Exchange for arbitrations of this type has migrated to, through the NASD and out to FINRA, as the relevant body.

THE COURT: No, I understand that, but you're --

MR. SCAROLA: If I'm wrong about that, it would go to the relevant body.

THE COURT: You're making a point about -- I think you're making a point about expertise, and the notion that you need a FINRA arbitrator because there are FINRA issues, that these are issues that a FINRA arbitrator has unique expertise in. It's one of your arguments.

MR. SCAROLA: It's one of them. I think there are two parts to that. In general, arbitration versus remaining in bankruptcy court in the face of an arbitration clause --

THE COURT: Right.

MR. SCAROLA: -- when looking at the factor, the considerations of whether state law issues versus bankruptcy issues predominate is simply whether it's FINRA or the AAA or whoever might be called out as an arbitrator, it's that, as I read the cases, is that the issues are not bankruptcy law-specific. If they were bankruptcy law issues to be applied in considering what is the claim for subordination and our defenses to it such as equitable subordination, which is not at stake in these circumstances because this is purely an argument over contractual subordination.

In a contractual setting, it's that the lack of a bankruptcy law-specific issue controlling the specific question --

THE COURT: Well, but even --

MR. SCAROLA: -- is a reason to enforce the arbitration clause.

THE COURT: Even then, one of the first issues that you highlighted is -- and let me be clear. This is not about the merits. I want to be clear about this. We're not talking about the merits, per se. We're only talking about the merits in the context of whether or not this should go to arbitration or not, but you go into the merits. So I have to follow you into the merits.

And one of the issues that you highlight is big issue -- whether or not this is an executory contract.

MR. SCAROLA: Yes.

THE COURT: Okay? That's an issue that the bankruptcy court uniquely, uniquely understands, uniquely understands.

MR. SCAROLA: But the case --

THE COURT: Whether or not something is an executory contract is a bankruptcy thing. It's not a purely state court thing.

MR. SCAROLA: We didn't get into the case law on this point, Your Honor, here, but the case law is to the effect that, whether or not there are continuing duties such as to make this an executory contract is, as we understand the case law, an issue of state law, not an issue of bankruptcy

jurisprudence, and that would argue for -- call it FINRA, or call it AAA. To me, arbitration with a small a of any sort, under the prevailing factors and what's discussed in the cases, that, on that particular issue, would argue for an arbitration because it's a common law issue, not a bankruptcy law-specific question as to whether or not this is, in fact, an executory contract in the sense of whether or not there are continuing duties.

I don't know if you want to go further into the question of whether there are continuing duties, but, as we read the cases, it is -- yes, bankruptcy courts, of course, deal with executory contracts all the time. Other courts deal with executory contracts as well, and that particular question, when it comes up in the bankruptcy context, of whether or not any contract happens to be an executory contract is a matter of the state law that governs that contract.

THE COURT: But, I mean, you set up the conversation by reference to the core versus non-core distinction, but you virtually immediately then dismiss it because you -- I mean, what you're saying is that, well, core, non-core, but that really shouldn't be the test. The test should really be whether it's an issue that's purely a bankruptcy issue as opposed to a state law issue, but that's not the test. The focus is core versus non-core.

MR. SCAROLA: Your Honor, even if this is a core

matter -- and I think, if our papers weren't clear on this, let me try to say it this way, because I think our position is a little different from the way Your Honor has expressed it.

Even if it is a core matter -- and let's assume, for the sake of argument, that it is -- the cases still say that there's a presumption in favor of arbitration, and you still have to look at the same factors that I am discussing.

THE COURT: You have to look at whether or not there's a conflict with fundamental principles of bankruptcy.

MR. SCAROLA: And, to do that, I mean, in brief, I think the -- I would identify four in a way different from the way I framed them in our papers, but I think the way to frame what the salient factors are here is the state law specific issues we talked about a moment ago; second, whether this particular dispute is central to this particular bankruptcy.

THE COURT: You don't think that determining the relative priority of similarly situated creditors is an important issue that requires a consistent application and decision as we enter the sixth year of this proceeding?

MR. SCAROLA: It is important to every case. It is important to this case. But is it central to this case --

THE COURT: No, but you see, that's what --

MR. SCAROLA: -- in the way --

THE COURT: What you've done is what you've said is

well, but in every case, the Court has to determine relative priorities. This is not a case in which we're talking about the liquidation by an arbitration of the amount of someone's claim, a classic arbitration.

MR. SCAROLA: I understand.

THE COURT: Right? This is an entire host of claimants relying on a particular interpretation of a subordination provision.

MR. SCAROLA: I understand. And that being the case, the trustee hasn't cited in its papers and we're not aware of any case that says the fact that it's a subordination issue takes it out of the realm of being sent to arbitration where there is a governing arbitration clause.

So, in my understanding of those cases, yes, it affects the case as a whole. Yes, it's important to the bankruptcy, but, in terms of a quantitative analysis, the papers that I've reviewed from the reserve's motion that was heard this morning and the earlier reserve's motion indicate some 20 to 27 billion in general unsecured creditors claims.

The amount of client claims that we're representing here are, I expect, based on the back of the envelope, going to be significantly less than one percent of the overall general creditor claims.

THE COURT: But that's not the test, either. I mean, you --

MR. SCAROLA: It is a part of the test, I think, in terms of its centrality to the case as a whole. I didn't mean to cut Your Honor off, but I think that that is a factor.

To distinguish it from a case such as Best Products, which was cited by the trustee, which talks -- it's not an arbitration case, but it talks about subordination being the core issue. But, in Best Products, the subordination issue there required -- I'm sorry. The subordination issue involved a settlement that required enforcement of the subordination agreement in, I think, a Chapter 11 context to get everybody onboard. And, if that didn't happen, the whole thing was going to blow up and not happen.

That's certainly central to that bankruptcy. Our claim, as important as it is to my group of clients, is not central to this bankruptcy in anywhere near the same sense, and I believe that what I just described in the Best Products case is what --

THE COURT: But then, you're suggesting that there's some kind of a dollars test. So, in other words, if it's only going to affect one percent of the claims pool, you know, then it's not central. If it's going to affect five percent, it's not central. Oh, wait, it's getting up around ten percent. Maybe that's a little more central. That's not a principled distinction.

MR. SCAROLA: I'm arguing that it's part of a softer

test. I've never seen a case, say, that there is a hard dollars test, and I don't think there is one, because it is, I think, more qualitative than that.

If it were less than one percent, but it were in some way like the facts -- and Best Products is the best I can come up with as an analogy right now -- that it somehow was going to impact the bankruptcy in other ways -- or I should say the progress of the case to its conclusion, then the dollar amount or the percentage amount, I think, wouldn't matter.

But here, this is an issue in a box, if you will. I mean, it's a contained issue. It's either going to be a determination that there is or is not subordination. It's not going to affect the progress of this case, which, as I understand it, will go on another three to five years. A resolution in a bankruptcy is going to be faster, cheaper, more efficient than under the federal rules. It's not a comment on this Court. It's a comment on litigation, as I understand it, under the federal bankruptcy rules (sic).

THE COURT: Resolution in a bankruptcy or resolution in arbitration?

MR. SCAROLA: Resolution in a bankruptcy -- I'm sorry. I misspoke.

THE COURT: You misspoke.

MR. SCAROLA: The resolution in an arbitration. I apologize.

THE COURT: Okay. Well, let's talk about that, because I don't think I agree with you on that, either. If the matter doesn't go to arbitration, then the trustee can file a motion for summary judgment in ten days, and I'll hear it, and we'll be done.

MR. SCAROLA: I don't think that is the kind of efficiency that the cases talk about. That's not even an argument that the trustee --

THE COURT: Well, --

MR. SCAROLA: -- has made. The cases don't talk about whether or not the case can be over because of a motion, and I don't know that --

THE COURT: One of your arguments --

MR. SCAROLA: -- they can --

THE COURT: -- is that it's going to be more efficient to go to arbitration, and I'm suggesting to you that that's not -- that the facts are not consistent with that, that this is a matter of contract interpretation where there is language that one might argue is plain on its face and that, therefore, would be amenable to a summary disposition on a summary judgment motion. We're not there yet because we're here first, and I have to decide whether or not send it to arbitration or not.

But, to the extent that one of the factors is efficiency, you make these arguments. You say it's just

indisputably going to be much quicker and much cheaper to go to arbitration, and I don't agree with that.

MR. SCAROLA: Your Honor, there is no party that's standing before you in any case where there's potential for arbitration where the same couldn't be said that Your Honor could make the decision on a motion faster and more swiftly than might be made in arbitration. That would take every arbitration -- unless this is going to be predetermined or prejudged to be one that --

THE COURT: I'm just --

MR. SCAROLA: -- shouldn't go forward through discovery.

THE COURT: I'm just --

MR. SCAROLA: Every arbitration has --

THE COURT: I'm just asking -- I'm just responding to your argument. Your argument is it'll be faster and easier to do it in arbitration, and I don't believe that that's true in this case.

MR. SCAROLA: And I guess I have, as my answer to that, if I may, I don't believe it's within the permissible factors for the Court to look into the possible motion that could be made to decide I might well dismiss this case --

THE COURT: Okay. So --

MR. SCAROLA: -- based upon any record, much less this one.

THE COURT: Now you're putting words in my mouth. I am merely responding to the fact that you make an argument somewhere in these papers that it'll be much faster to go to arbitration. Am I mistaken?

MR. SCAROLA: That is our argument, yes.

THE COURT: Okay. And I am responding to that argument by saying that it ain't necessarily so.

MR. SCAROLA: It is possible that, if for other reasons, Your Honor ruled that this case does not go to arbitration, they could make a motion -- I don't think they could make a sound motion. It's too early. It has to be a summary judgment at this point -- motion at this point. They've already relied on matter outside the record, and I think the kinds of arguments that they've articulated on merits --

THE COURT: But --

MR. SCAROLA: -- issues necessitate --

THE COURT: What have they relied on that's outside the record?

MR. SCAROLA: Well, their affidavit has a stack of papers outside the record, which I don't think they're ultimately going to be relevant to what should be the issues on the successorship point.

THE COURT: So this is just a legal issue. Again, we might be talking about the merits, but I'm not considering the

merits today, only insofar as they relate to whether or not this should go to arbitration.

MR. SCAROLA: In this context, it's hard for me not to say I don't see how a summary judgment motion on fact-intensive questions could be resolved at this early stage without there being discovery. And, if Your Honor disagrees --

THE COURT: But --

MR. SCAROLA: -- in particular, I'd love an opportunity to talk about that in relation to the particular defenses we've raised. As a matter of theory, yes, of course, as a matter of theory, that decision could happen. Could that same decision happen in an arbitration just as swiftly? I don't think that's in this record. I don't know. I mean, I'm not in a position to be --

THE COURT: I'm merely responding to an argument that you made. You argued in your papers that it'd be faster to go to arbitration. The reason you made that is because you wanted me to consider that in support of your position. That's why I raised it. We can move on to another point.

MR. SCAROLA: Well, I mean, if I just may, I don't know that anybody could say on this record, and I don't know the answer whether the same kind of motion, if it were viable, couldn't be made in an arbitration context, and, if it could be made, then that doesn't make it faster or less fast. And, when we've talked about the ability to get through an arbitration

more efficiently and swiftly than a full litigation under the federal rules of bankruptcy procedure and the federal rules of civil procedure, that adverts to the general proposition the extent to which discovery is broader, depositions are broader, timelines are often broader under the two sets of federal rules that would apply here.

And, in an arbitration, whether it's FINRA or whether it's the AAA, whether it could ultimately be some other forum that the parties could agree to, if you directed arbitration, it is in all likelihood and in most, I think, practitioners' view and most courts' view, a faster line from point a to the end of the case than leaving aside the possibility of some early motion for a resolution. And I guess --

THE COURT: So did you finish your presentation of the factors that you think that --

MR. SCAROLA: Well, you know, I --

THE COURT: -- would inform my discretion to not allow this to go to arbitration?

MR. SCAROLA: I think the fourth that I would have mentioned or would like to mention is the prospect of delay as an issue. Sending this to arbitration will not delay the conclusion of this bankruptcy case. It's a factor cited in cases of this type frequently where the case is simply not as large and closer to a resolution.

This case would be resolved in an arbitration far

sooner than the bankruptcy as a whole would be concluded. In addition, in a bankruptcy, obviously, there are rounds of appeal leaving aside the costs that adds another two, two-and-a-half years, as I understand what the progress of two rounds of appeal would be.

And, leaving aside the limited rights of appeal in a bankruptcy -- in arbitration context, you simply don't have that. So, in terms of expedition and costs in that regard, there is more certainly of a definitive result on a faster track and, in fact, one more certain and swifter than many round.

If all this were to be done by motions and rounds of appeal, we would be at this much longer than if we had a definitive decision in an arbitration. And, in terms of rounding out the factors, I think those are the salient factors as we understand them.

THE COURT: But isn't your description of the core, non-core issue -- I think it falls a little short. Because, as I am reading your papers, one of the themes on the merits is there's an agreement entered into in 1985 that, for whatever reason, was never freshened up. Right? We're talking about a 1985 agreement --

MR. SCAROLA: Yes.

THE COURT: -- with an entity called Shearson.

MR. SCAROLA: Yes.

THE COURT: Right? And the exercise that you want to go through with an arbitrator is to demonstrate that, in some places where it says Shearson, it just means Shearson, not its successors, not this debtor, not LBI. But, in other places, it means LBI. You want --

MR. SCAROLA: No.

THE COURT: -- a claim against LBI, but you don't want a subordination LBI. You just want --

MR. SCAROLA: No, that is not our argument, Your Honor.

THE COURT: It absolutely is your argument. In fact, you say that, for the purposes of the obligations, you distinguish between rights and obligations.

MR. SCAROLA: That's because the contract does.

THE COURT: Lehman doesn't get --

MR. SCAROLA: We're not picking and choosing. The contract does. And it's in that respect that I am disagreeing with Your Honor's characterization of our argument.

THE COURT: But embedded in that is the fact that you are asking for a determination of whether or not LBI and Shearson are the same -- LBI is a successor of Shearson, correct?

MR. SCAROLA: We are defending a claim to subordination on the grounds the contract relied upon the trustee advisably used the word --

THE COURT: That's not my question.

MR. SCAROLA: -- successor in some places.

THE COURT: My question is --

MR. SCAROLA: And that determination would, in fact, be --

THE COURT: Yes.

MR. SCAROLA: -- that once Shearson --

THE COURT: Yes.

MR. SCAROLA: -- transmogrifies (sic), for lack of a better word, into a successor as the case law understands what a successor is --

THE COURT: Right.

MR. SCAROLA: -- the subordination provisions do not apply --

THE COURT: Okay. But you're still not answering my question.

MR. SCAROLA: -- to this obligation.

THE COURT: One of the things that you want me to determine is whether Shearson and Lehman, for certain purposes under this contract, are one in the same.

MR. SCAROLA: In effect, that would be not for purposes of this motion, but for purposes of our defense.

THE COURT: Yes.

MR. SCAROLA: That would be --

THE COURT: Okay, right.

MR. SCAROLA: -- a characterization of one of the issues.

THE COURT: Right. It's a pretty core issue, determining who LBI is, who LBI was, who it's a successor of. Nothing could be really more core for a bankruptcy court than determining historically and as a matter of juridical contours who the debtor is and who the debtor was, what its obligations and rights are. That's like the whole ball of wax.

MR. SCAROLA: Your Honor, I don't think --

THE COURT: That's what you are asking. In footnote ten in your papers, you, in fact, say that you want to go through all the parts of the agreement and determine in which places Shearson just means Shearson and in which places Shearson means Lehman. And that strikes me as being a pretty big issue and one that one could argue a bankruptcy court and not a FINRA arbitrator ought to decide.

MR. SCAROLA: Your Honor, I do not think that that's an issue that, as far as I'm aware, would affect any other part of this bankruptcy case, because it has to do with something unique as to what happened in 1985. Now, I know that there are in the records and in the record of this case four other deferred compensation agreements relatively contemporaneous, but I think I refer to that in the papers, with the one that's at issue here.

In those agreements, the word successor was used

advisedly there to describe what the entity is and where there would be subordination down the road. In our agreement, we don't have to pick and choose, because it's a clear roadmap that the word successor is not used to define the entity or the debt where there would be subordination, but it is used in a clear pattern advisedly in other places, some having to do with clawbacks, some in the very final paragraph, which talks about a successor will continue to owe this money.

And, in doing an analysis of that, those are state law contract questions. Is it central and core to this bankruptcy? I respectfully disagree that it is at this point in the sense of who the debtor is.

There's no question as to who the debtor is, and, for all material purposes, the kind of analysis that's necessary to answer the question we posed in our second defense is impertinent to anything else in this bankruptcy as far as it's, at least, hit my radar. It's possible that there is some issue, but I don't believe that there is.

I think it's a one off, if you will, as far as the rest of the bankruptcy case. So is it any different from any other state law contract interpretation question? I don't believe so. I mean, let me just focus on that for a moment.

I believe it is a FINRA issue, because this was the largest industry -- I mean, at the time, it was the New York Stock Exchange arbitration. This is the largest, I believe,

deferred comp. plan, and it's going to be the last, because this was being done and many companies were doing an agreement -- I mean, a deferred comp. plan of this type in anticipation of the rate and tax law changes that were about to come into effect.

The numbers of people are obvious. The dollars are significant. The people who were drafting the plan were -- and the outside lawyers as well as the in-house people who were working with this are senior officers. As it happens, they're also in the plan.

To some extent, it is --

THE COURT: We're getting extremely far afield. So --

MR. SCAROLA: I am getting into the merits, but I think it's part of the question that's posed here as whether or not this is a fact-intensive one-off question or whether this is something central to this particular bankruptcy case.

I have a group of clients, including the people who proposed, argued for, sold to other members of the group, and largely structured with counsel this plan. Call it the magic words of successorship are not in here where it ought to be. Where it was in four other agreements that were done in the same timeframe.

THE COURT: We are now not just waiting in -- you're now arguing the interpretation of the subordination clause.

MR. SCAROLA: I am.

THE COURT: So I really don't want to do that today.

MR. SCAROLA: I am, but I'm doing that for the sake of saying you can't make a determination like that without the full development of the factual record.

THE COURT: Or --

MR. SCAROLA: But, more than that, our clients bargained for an industry arbitration of that issue. An industry arbitration meaning the arbitrating body that regulated this entity. I mean, it's common parlance associated persons, broker/dealers. These kinds of issues were specifically called out for arbitration in 1985 about an issue that, by its nature, wasn't going to come up for 20 or 50 years, that could be important, because this was expected to be the significant part of people's retirement income down the road.

When they bargained for arbitration, they did it in a context where this agreement was being written to deal with the net capital requirements, to deal with Shearson as it was then understood, to deal with the subordination issue in a way that other deferred comp. plans didn't. So, when they said arbitration of the subordination questions, there's special reason to give credit to them, because the parties were saying if there's a bankruptcy as well as similar scenarios -- if there's a bankruptcy, what's subordinated and what's not ought

to get decided in the context of what we understand to be the arbitration overseen by the body that regulates all of us.

That was what was happening. That's real. That's in the papers.

THE COURT: No, but what you're saying --

MR. SCAROLA: And it's on --

THE COURT: But what you're saying is actually inconsistent with that, because what you're saying is that when Shearson ceased being Shearson, the subordination fell away.

MR. SCAROLA: The subordination fell away, but --

THE COURT: So that's entirely inconsistent with the notion that, in 25 years later when there was -- 30 years later when this was this bankruptcy proceeding, there was then going to be an arbitration over subordination. That's different from what you just said.

MR. SCAROLA: The reason it's not inconsistent is because the obligation persists in the successor, according to paragraph 11, which is on page 18, but the --

THE COURT: Okay. We are not only into the merits, --

MR. SCAROLA: -- subordination provisions do not.

THE COURT: -- but you've now given me an evidentiary hearing. So we're going to dial this way back to what the issues are, and I'm going to ask the trustee to respond to your arguments, and you can have some further time on reply.

All right?

MR. FITZPATRICK: Good afternoon, Your Honor.

THE COURT: Good afternoon.

MR. FITZPATRICK: James Fitzpatrick, from Hughes Hubbard, for the trustee.

THE COURT: So why isn't Mr. Scarola right?

MR. FITZPATRICK: Pardon me, Your Honor?

THE COURT: Why isn't he right?

MR. FITZPATRICK: Because there -- the case law's clear. There are two factors. The first is whether it's core, and the second is whether there is a conflict.

On the issue of whether it's core, I don't think it's an issue of even if it's core, we can assume it's core. I think the Second Circuit law is clear that, not only is this -- is a subordination issue core, it's absolutely central.

In in re: Best Products, referring to Section 510 of the code, which enforces subordination, and an additional, though not referred to here, 726(a), which requires the trustee to take account of subordination, in re: Best Products called it fixing the order of priority of creditor claims against a debtor is an integral and historic bankruptcy function. And the Second Circuit then also cited with approval of the bankruptcy court stating, "It is hard to imagine an issue that is more at the heart of the bankruptcy process than is this."

So I don't think it's an issue of assuming that it's

core. I think that, not only has it met the first prong, but that prong weighs very heavily in favor of not arbitrating these claims.

Moving on to conflict, I think that --

THE COURT: Well, but what about the argument that, you know, this is just, you know, a little, tiny piece of the creditor pool and, therefore, it just won't matter? I mean, in other words, I think the argument that the way Mr. Scarola put it in his papers, which is, of course, compelling on a human level --

MR. FITZPATRICK: Yes.

THE COURT: Although I'm not so sure relevant on a legal level -- is that this may be core to the debtors, but there is nothing that could be more core to the folks who agree --

MR. FITZPATRICK: Yes.

THE COURT: -- to take this deferred compensation. So why isn't that compelling, that, you know, we're -- you know, there's this giant LBI proceeding, and this is just this little piece, and it won't move the dial, I think, was the expression.

MR. FITZPATRICK: Yes.

THE COURT: And I think on the numbers, I mean, I think that's true. It's not going to move the dial.

MR. FITZPATRICK: Yes.

THE COURT: Right?

MR. FITZPATRICK: Yes, that's true, Your Honor, and I'm not disputing for a second the importance of this issue to the claims at all, of course, but that's not the test. The issue is whether is it a core bankruptcy function and a core bankruptcy court function to determine the priority of the claims. And the case law is crystal clear that it's not just core, but central, and there's just not a dollar value test to it. That's not the relevant factor to be applied.

And it's also -- I mean, the issue of -- the importance of the issue to the claimants is not a reason for it to be arbitrated, we submit. I mean, it's an important issue, but it's still important that it still be heard in the right forum, and we'd say on an issue as core as this --

THE COURT: Well, clearly, the determination -- I mean, the elephant in the room is the assumption that an arbitrator is going to rule in favor of the claimants and that this Court is not going to rule in favor of the claimants. I think that's the elephant in the room.

I'm not saying anything that's surprising or untoward. A party always wants to go to the forum that thinks it's going to be the most favorable. I mean, I don't think it's a question of whether this Court or some arbitrator will better understand the issues. And I didn't hear Mr. Scarola to be making those arguments. So -- right?

MR. FITZPATRICK: I didn't hear him to make those arguments, either.

THE COURT: Yeah. But, you know, in their view, they bargained for a compensation package. They agreed to take this deferred compensation explicitly on the understanding that, if and when push came to shove, they'd have a right to arbitrate.

MR. FITZPATRICK: Well, there's two points on that, Your Honor. The first is it's not a question of whether the arbitration clause on its terms would cover this. If the arbitration clause weren't applicable, we wouldn't be here.

THE COURT: Uh-huh.

MR. FITZPATRICK: All of the cases have arbitration clauses that are applicable.

THE COURT: Right.

MR. FITZPATRICK: And then, the question becomes whether, under the two-prong test, Your Honor should nonetheless hear it, and we say that it should. I do think, on the issue of the arbitration clause itself, it's not just a bankruptcy-related arbitration clause. There are a lot of different prongs that could have triggered it, many outside the context of bankruptcy.

We're not talking about a situation where they -- at least on the face of the document, it looks as though they were bargaining only for a bankruptcy-related situation. But, even if they were, we would submit that's not the relevant test,

because again, all of the cases have applicable arbitration clauses.

And so, on the two prongs, Your Honor, first we'd say the core prong clearly weighs in favor of no arbitration. In terms of the conflict, taking such a core issue of the bankruptcy from the legal perspective and sending it to arbitrators, specifically when the only issue going to the arbitrators would be the question of whether or not these claims are subordinated. So we'd submit that just sending an issue that's that central to bankruptcy law and bankruptcy procedures to arbitrators is a conflict.

And if Your Honor had seen the papers in the cases, the types of cases where courts in this circuit have not sent things to arbitration include declaratory judgment actions against insurance companies to bring money into the state, the issue of whether a painting that was consigned to the debtor was appropriately property of the estate. We'd submit certainly the issues here are every bit as much of a conflict as any of the issues where Second Circuit courts have denied arbitration.

And the one Second Circuit case, I believe, that the claimants cite, the MBNA case, where arbitration did go forward, we think is clearly distinguishable because there the debtor had been discharged already. So there really wasn't the issue of the impact on the estate.

And the last thing I'd note, Your Honor, on --

THE COURT: Well, I think Mr. Scarola --

MR. FITZPATRICK: Yes.

THE COURT: -- is kind of making the argument that that's not dissimilar to here, because for a number of reasons. One, the huge size of the pool and how this isn't going to move the dial and the case is just going to be rolling on for another three to five years anyway. So I think -- not to put words in Mr. Scarola's mouth, but I think that's why he thinks that that is applicable.

MR. FITZPATRICK: Understood, Your Honor. And the two points -- and again, I don't think the test is monetary. I think the test is whether it's a core bankruptcy issue or not.

And secondly, we do have certainly what we think and what Judge Peck put in place and what Your Honor is continuing to operate a very efficient claims procedure that we do think can get through these quickly and efficiently. Now, it is true that, at the claimants' request, the subordination part of this case is procedurally an adversary proceeding, and we did agree to that. But nonetheless, this will, once that issue is determined, will again be part of the claim process, which we think is an efficient process that will move forward quickly.

And, unless you have --

THE COURT: Okay.

MR. FITZPATRICK: -- questions, Your Honor, that's

all I have.

THE COURT: Okay. Thank you.

MR. FITZPATRICK: Thank you, Your Honor.

THE COURT: Mr. Scarola, anything more you'd like to talk about?

MR. SCAROLA: The standard Mr. Fitzpatrick talks about, even in his papers, is the requirement that there be a severe conflict. I don't believe that he has articulated a severe conflict that meets that test.

Talking about the Best Products case in which he alluded to in his presentation, I spoke about, it's a wholly different kind of context where that subordination issue, which wasn't even exactly a subordination issue, was going to blow up a Chapter 11 reorganization or not. This is --

THE COURT: I think the disconnect is looking at the conflict in a kind of pure intellectual sense, right, the importance of the bankruptcy court ordering the priorities among creditors. That's a biggy. I mean, that's one of the, you know, top five things that the bankruptcy code imposes in a bankruptcy process versus the way you're looking at it. You're looking at it much more in terms of the practical effect.

And what you're saying is that, even if it's a biggy, even if it's a really big conceptual conflict, in this case, it doesn't matter. It's not going to change the outcome, impede the progress, and that, therefore, the trustee in this case

shouldn't win the issue on is there a severe conflict, because we're just a bunch of little folks in this big case.

I think that's where the two of you kind of are going to have to agree to disagree. I think that's it. Doesn't that sound right?

MR. SCAROLA: Well, you'll tell us what you decide the answer is, I think, but if I could take up what I think is implicit in what Your Honor is saying?

THE COURT: Sure.

MR. SCAROLA: Is that, if it's subordination, it ain't going to arbitration is somewhat implicit as a --

THE COURT: Well, but let me --

MR. SCAROLA: -- rule, because it's in what you described as the top five.

THE COURT: -- give you a different example. Let me give you a different example. If, for example, the question was liquidating the amount of a claim, right, under FINRA arbitration, I don't think they could make that argument, right? But here the question is that the, you know, place of the claims in the capital structure of the debtors amongst thousands and thousands of other creditors, including thousands and thousands of similarly situated, equally aggrieved former employees who, you know, if I had a magic wand or a money printing press, it would make my job a lot easier.

But one of the really difficult things about this

case is hearing from all the employees who served for so many years and are now coming up short. So I want you to -- so that's kind of the conflict that I have, to apply the law in an appropriate way against the backdrop of fully understanding, you know, what the stakes are, you know, for everybody, most particularly, of course, the individuals. So I don't want you to think that I'm not focusing on that, because I have.

MR. SCAROLA: I understand that, but if I may just return to the point about --

THE COURT: Sure.

MR. SCAROLA: -- whether subordination, in general, is so core a concept that is it the case that if subordination is involved, and it's the order and priority of the claims, would there never be then a situation where an arbitration clause should be enforced?

THE COURT: No, but that was my point is that I don't have to decide all those other cases that maybe where it would be appropriate. Just yesterday, I issued a decision on a subordination issue, issue of first impression under 510(b). So I think last week or last month I issued another issue about subordination. I mean, it's the bread and butter of what this Court has to do is the sorting of the claims among the priorities.

So might there be one somewhere? Sure, but that's not what I have to decide.

MR. SCAROLA: In deciding the case that you issued the order on yesterday or the day before -- I'm lost in this week at this point -- I mean, I read that decision, and what you were construing was a novel issue under Section 510(b), as I understand it. That's a bankruptcy issue. And, under the prevailing test, that belongs here. There wasn't even an issue of arbitration, as I understand it, but that belongs here.

If you were to rule against this motion on the ground that it involves subordination and that's so core and so central that you have to keep it because it's subordination, then, given how tangential to the rest of the case this is and how unaffecting to the rest of the case this is, that will serve as a precedent for the concept that, if it's subordination, it ain't never going to arbitration. You're not going to have to make that ruling, because those cases aren't in front of you.

THE COURT: Ah, I don't -- yeah, I don't think -- you know, lawyers can make whatever argument they decide to make, but I don't think that that necessarily --

MR. SCAROLA: There is no issue that we're going to litigate when we get into the facts of what this agreement says, why it says it, and how it got there, assuming it is ambiguous -- I don't believe it could be construed on a motion against us. I think it could be construed for us. We'll find out if we stay here and have that kind of motion practice.

I think in all likelihood that motion on the successorship issue results in a determination that there needs to be discovery, and that discovery includes classic state court parole evidence, a whole big, long, deep inquiry into something that happened 30 years ago where both sides get to explain why this is written the way, seamlessly against subordination, in our view, and different from all the contemporaneous agreements done by the same people and the same law firm. That is the kind of morass that I don't think the bankruptcy courts are intended to get into if there isn't something about that dispute that's central to the bankruptcy.

THE COURT: Really?

MR. SCAROLA: If it is not central to the bankruptcy -- I mean, obviously, I'm talking about the context of where there's an arbitration involved. You deal with those disputes all the time, by their nature.

THE COURT: Morasses of --

MR. SCAROLA: Morasses of all sorts.

THE COURT: All the time.

MR. SCAROLA: But I meant -- and I think it's in context clear I'm talking about where there's an arbitration clause and where there is a forum that the parties selected to parse that it should be parsed there, not because this Court is not good enough. That was one of the points you discussed, in effect, with Mr. Fitzpatrick. Not because we think we have a

better chance of winning or losing.

Because by going to arbitration, we waive those two rounds of appeal. And all of these issues, if they're to be decided on motion, get reviewed in two different places.

THE COURT: Right.

MR. SCAROLA: We come in here seeking arbitration after significant deliberation not about which way Your Honor is going to rule because we don't know, but about our own views of expediency, what can be afforded, and what did the parties bargain for. And, if the parties bargained for that determination, --

THE COURT: Right, but --

MR. SCAROLA: -- and it's not going to hurt the rest of this case, --

THE COURT: -- again, you know, it's always going to be the case that, in this type of situation, there's an arbitration clause and the question is whether to honor it or not. So saying that the parties bargained for it doesn't really advance the ball. There is an arbitration clause.

MR. SCAROLA: Fair enough. I agree.

THE COURT: The trustee acknowledges that there is an arbitration clause. The reason we're here is to decide whether or not bankruptcy should trump arbitration. That's it, plain and simple.

What I would like to do is take a little recess and

try to give you a decision, but I'd like to come back at 3:00. So would you mind waiting?

MR. SCAROLA: No, of course not.

THE COURT: All right. All right. We'll go back on the record at 3:00. Thank you.

(Recess at 2:48 p.m.)

(Reconvened at 3:01 p.m.)

THE COURT: All right. Please have a seat.

All right. Thank you both for the presentations and the materials. Let me give you a decision.

The trustee filed six separate omnibus objections, the 112th, the 113th, the 114th, the 138th, the 147th, and the 189th omnibus objection to general creditor claims seeking to subordinate 437 general creditor claims asserted by 401 former employees seeking deferred compensation pursuant to the executive and select employees' plan, or the ESEP plan.

In 1985, each claimant signed an agreement with Shearson Lehman Brothers, Inc. setting forth the terms of the plan. The trustee asserts that, pursuant to the express subordination language set forth in paragraph nine of each agreement, each claimant agreed that his or her benefits would be subordinated to payment in full of LBI's unsubordinated obligations. Three hundred and forth-eight of the claimants opposed, either formally or informally, the relevant omnibus objection.

After a hearing on the motion of the trustee with opposition by a group of 341 claimants, referred to as the claimants, represented by common counsel, the Court entered an order dated April 1st, 2014 at ECF 8576 converting the omnibus objections into a consolidated adversary proceeding and deeming specific provisions of the omnibus objections sufficient in lieu of an adversary complaint. Pursuant to the same order, the Court expunged the claims of the 53 claimants who did not respond to the relevant omnibus objection.

The claimants filed their answer to the converted complaint on April 29th, 2014. The answer alleges as an affirmative defense in paragraph 102 that, quote, "The trustee's effort to seek subordination in this case are subject to a requirement by the parties' contract that the issue presented be resolved by mandatory arbitration," end quote.

On June 3rd, 2014, the Court entered an agreed case management and scheduling order at ECF 9033 setting June 6th, 2014 as the deadline for the claimants to file a motion to compel the arbitration of the issues in the adversary proceeding. The claimants timely filed the instant motion seeking to, one, compel arbitration of the issues presented in the adversary proceeding pursuant to the arbitration clause in Section 5.1 of each agreement and, two, stay the adversary proceeding pending the final outcome of the arbitration.

Each of Mary Camilli-Bernat and James Knipp

proceeding through counsel, and Johnathan H. Lang, proceeding pro se, has joined in the motion. In addition, on July 22nd, 2014, counsel to the claimants filed a second supplemental notice of appearance stating that the claimants now comprise 344 individuals.

The trustee opposes the motion and submits that this Court is the appropriate forum for this proceeding. The arbitration clause provides relevant part that, quote, "Any controversy arising out of or relating to the subordination provision of paragraph nine of each agreement shall be submitted to and settled by arbitration pursuant to the constitution and rules of the New York Stock Exchange and that Shearson and employee shall be conclusively bound by such arbitration."

The claimants argue that, one, there is a strong presumption in favor of arbitration and, two, LBI will not be prejudiced by enforcement of the agreements' express arbitration clause. The trustee counters that it is well within the Court's discretion not to mandate arbitration based on a clause like the one at issue, particularly where, as here, the issue of claims subordination clearly is a core bankruptcy issue and arbitration runs the risk of direct conflict with the purposes of the bankruptcy code.

The Court agrees with the trustee and will deny the motion. The Federal Arbitration Act provides in pertinent part

that arbitration agreements, quote, "shall be valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract," 9 U.S.C., Section 2. By this provision, the Federal Arbitration Act establishes, quote, "A federal policy favoring arbitration," end quote, and requiring that federal courts rigorously enforce agreements to arbitrate, Shearson American Express, Inc. v. McMahon, 482 U.S. 220 at 226.

Like any statutory directive, however, this mandate may be overridden by a contrary congressional command, Id. The relevant case law prescribes that, if Congress intended to make an exception to the Federal Arbitration Act for a particular claim, quote, "Such an intent will be deducible," end quote from the text or legislative history of a particular statute or, quote, "from an inherent conflict between arbitration and the statute's underlying purpose," Id. at 226, 227.

The Second Circuit has recognized that it is within a bankruptcy Court's discretion to decline to compel arbitration when a conflict exists, quote, "between the bankruptcy code, which favors centralization of disputes concerning a debtor's estate and the FAA, which advocates a decentralized approach to dispute resolution," in re: Crysen/Montenay Energy Co., 226 F. 3d 160 at 166, Second Circuit 2000 citing U.S. Lines v. American Steamship Owners Mutual Protection and Indemnification Association, Inc., in re: U.S. Lines, 197 F. 3d 631 at 640,

641, Second Circuit 1999.

The inquiry then, quote, "with respect to the exercise of that discretion, is, quote, 'whether any underlying purpose of the bankruptcy code would be adversely affected by enforcing the arbitration clause,'", Cibro Petroleum Products v. City of Albany, in re: Winimo Realty Corporation, 270 B.R. 108 at 118, Southern District of New York 2001, quoting U.S. Lines, 197 F. 3d at 640.

It is in engaging in this inquiry that the Second Circuit has made a distinction between core and non-core proceedings. When a proceeding is core, the bankruptcy Court then must analyze whether arbitration, quote, "would seriously jeopardize the objectives of the bankruptcy code such that there is an inherent conflict between arbitration and the code," U.S. Lines 197 F. 3d at 640 to 41.

Generally, proceedings arising under Title 11 and proceedings arising in a case under Title 11 are referred to as core proceedings. Whereas proceedings related to a case under Title 11 are referred to as non-core proceedings. See Bender v. PriceWaterHouse and Company, LLP in re: Resorts International, Inc. 372 F. 3d 154 at 162, Third Circuit 2004 citing Juan Collier (ph) on bankruptcy, paragraph 3.022 at 3-35, 15th edition.

Bankruptcy core jurisdiction extends to all civil proceedings arising under Title 11 or arising in a case under

Title 11. Joremi Enterprises v. Hershkowitz, in re: New 118th, LLC, 396 B.R. 885 at 890, Southern District of New York Bankruptcy 2008. See also 28 U.S.C. Section 157(b)(1) stating that, quote, "Bankruptcy judges may hear and determine all core proceedings arising under Title 11 or arising in a case under Title 11."

A core proceeding, as a general matter, is one that invokes a substantive right under the bankruptcy code or could only arise in the context of a bankruptcy case. See New 118th, 396 B.R. at 890. Put another way, a proceeding can be core, quote, "by virtue of its nature if either, one, the type of proceeding is unique to or uniquely affected by the bankruptcy proceedings or, two, the proceedings directly affect a core bankruptcy function," end quote, U.S. Lines 197 F. 3d at 637.

Core bankruptcy functions include fixing the order of priority of creditor claims, centralizing all disputes in a single forum, and preserving and equitably distributing the estate's assets, Id. citing in re: Johns-Manville Corp., 827 F. 3d, 89 at 91, Second Circuit 1988; Kracken Investments, LLC v. Jacobs, in re: Salander-O'Reilly Galleries, LLC, 475 B.R. 9 at 30 to 31, Southern District of New York 2012.

It is clear then that the dispute presently before the Court where the claimants' claims fall in the priority scheme of distributions to LBI's general creditors falls within the Court's core function. The Second Circuit also has held

that disputes involving enforcement of a contractual subordination agreement are core and, quote, "essential to the administration of the estate," Resolution Trust Corp. v. Best Products Company in re: Best Products, 68 F. 3d 26 at 31 to 32, Second Circuit 1995.

Moreover, although the Court is reluctant to discuss the merits of the claims at this early stage, it notes the claimants have asserted that the subordination language in the agreements does not subordinate their claims to other claims against LBI, but only to claims against Shearson. Claimants argue that Shearson's obligations under the agreements run to its successors, but the subordination provision does not.

They submit that LBI is an entity distinct and different from Shearson, which is defined in the agreements as Shearson Lehman Brothers, Inc., motion paragraph four. Certainly, there can be no question that the determination of the definition of a debtor entity is a core function of the bankruptcy Court that is overseeing the administration of the debtor estate.

Arbitrating the subordination issue would jeopardize the objectives of the bankruptcy code and conflict with the integrity of the bankruptcy process in this case. An outcome contrary to the provisions of the bankruptcy code, which, by their very nature, evidence Congress' intent to treat differently-situated creditors differently, would disrupt the

priority scheme that this Court is duty-bound to apply to all creditors in this SIPA liquidation.

The arbitration clause provides that disputes arising under the subordination provisions be arbitrated by FINRA. As the trustee argues, this arrangement made sense when LBI was an entity operating under the rules of the New York Stock Exchange, trustee's opposition at paragraph 16.

Upon examination, however, the provisions of the agreement governing in the event of bankruptcy do not mention the stock exchange and do not require interpretations of its rules. The stock exchange rules are irrelevant, and FINRA arbitration simply is not appropriate.

Congress simply could not have intended to turn over the determination of the relative priority of claims against the estate and the equitable distribution of the estate's assets in the largest SIPA liquidation in U.S. history of the financial industry regulatory authority to be decided under the rules of the New York Stock Exchange. Accordingly, the motion to compel is denied, and the trustee is directed to submit an order consistent with this ruling.

And, if you would be so kind as to run the order by Mr. Scarola before you submit it, I would be grateful.

All right? And then, at an appropriate point, I'll wait to hear from you folks to determine what's going to happen next, what you would like to do next in terms of calendar and

next steps, but I appreciate your coming in. I appreciate everyone's attention, and I wish you a good afternoon. Thank you.

UNIDENTIFIED SPEAKER: Good afternoon, Your Honor.

MR. LYMAN: Thank you, Your Honor.

THE COURT: Thank you.

(Whereupon, these proceedings were concluded at 3:15 PM)

I N D E X

R U L I N G S

C E R T I F I C A T I O N

I, Lisa Beck, certify that the foregoing transcript is a true and accurate record of the proceedings.

Lisa Beck

Digitally signed by Lisa Beck
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Date: July 31, 2014